



Disclosure Obligations and On-Going Administration of Bonds and Other Debt

**CDIAC ABCs of School Debt Financing
Concord – April 9, 2010**



What To Get From This Session

- Your role and responsibilities
- Professionals and others who can help
- When in doubt, ask



What We'll Be Discussing

- Disclosure
- Official Statement
- Continuing disclosure
- Tax law –
 - Private Use
 - Private Loan
 - Arbitrage and Rebate
- Project Management
- Accounting Issues



Disclosure Due Diligence

- ❖ Federal Securities Laws
 - Section 17(a) of 1933 Act – Antifraud Provisions
 - Rule 10b-5 – Antifraud Provisions
- ❖ Rule 10b5
 - “It shall be unlawful for any person.....
 - (a) To employ any device, scheme or artifice to defraud,
 - (b) To make any untrue statement of a *material* fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.....”



Disclosure Due Diligence (continued)

- ❖ Duty - Disclose all material facts (i.e., facts that are important to an investor in making an informed investment decision) and do not misstate any material facts

- ❖ The “Materiality” Standard
 - “[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest.”



Disclosure Due Diligence (continued)

- ❖ WHEN DO DISCLOSURE RULES APPLY?
 - New offerings
 - Annual Report under Rule 15c2-12
 - Any other circumstance where an Issuer is “speaking to the market.”



Disclosure Due Diligence (continued)

- ❖ Role of Staff:
 - Provide information to consultants
 - Review drafts of Preliminary Official Statement
 - Notify Board members of duty to review and disclose
 - Schedule conference call to review draft of Preliminary Official Statement
 - Distribute final version of Preliminary Official Statement to Board for review



Disclosure Due Diligence (continued)

Role of Board:

- Oversight
- Review draft Preliminary Official Statement
- Ask questions of staff and consultants
- Approve distribution of Preliminary Official Statement



Disclosure Due Diligence (continued)

- ❖ Questions for the Board to Ask:
- ❖ Am I aware of any information about the District that would be important for an investor to know?
- ❖ Is there any pending or threatened litigation against the District that could have a negative impact on the District's finances or ability to repay the debt?
- ❖ Are there any circumstances that exist or that are now unfolding that could place a demand on District reserves or create budget difficulties for the District?



Disclosure Due Diligence (continued)

Disclosure Considerations:

- ❖ Tomorrow's "hot topic" may be different than today's
- ❖ Disclosure must evolve to reflect changing circumstances
- ❖ Read the disclosure with "fresh eyes"
- ❖ If you think something may be a concern, raise the issue with colleagues and the working group
- ❖ There are no "stupid questions"



Disclosure Due Diligence (continued)

What can go wrong?

- ❖ Main avenue for attacks on disclosure is SEC enforcement
- ❖ SEC has power to bring civil actions or refer to Justice Department for criminal action
- ❖ SEC will bring actions against municipal issuers, also targets other participants
- ❖ SEC Investigation – fees for lawyers and consultants
- ❖ Adverse publicity
- ❖ Reduced market access
- ❖ May have to impose new procedures and oversight to settle SEC actions



Disclosure Due Diligence (continued)

Summary:

- ❖ Make sure that responsible officials are familiar with disclosure
- ❖ Review the entire POS
- ❖ Seek information and ask questions of the officials, employees, and professionals who supplied information to be included in the POS
- ❖ Ask follow up questions to determine the reasonableness of any assumptions or estimates that were used in the POS



Official Statement

- ❖ OFFICIAL STATEMENT
 - Preliminary vs. Final
 - ↘ Preliminary used to market certificates/bonds to potential investors
 - ↘ Final delivered to actual purchasers
 - Issuer's Document
 - Guidance
 - ↘ Federal Securities Law (Rule 15c2-12 and 10b-5)
 - ↘ Professional Guidelines (CDIAC, GFOA)



Official Statement (continued)

- ❖ OFFICIAL STATEMENT
 - Who Prepares?
 - ↳ Disclosure Counsel
 - ↳ Underwriter's Counsel
 - Who Reviews?
 - ↳ Staff
 - ↳ Public Officials



Official Statement (continued)

❖ OFFICIAL STATEMENT

- Liability
 - ↘ Issuer strictly liable
 - ↘ Underwriter
 - “Due diligence” defense - reasonable investigation
- Rule 15c2-12
 - ↘ Deemed Final Preliminary Official Statement
 - ↘ Permitted Omissions of Pricing Data



Official Statement (continued)

❖ OFFICIAL STATEMENT

➤ Contents

- Description of Certificates or Bonds
- Security and Sources of Payment
- Estimated Sources and Uses
- The Leased Premises
- The Project
- The Issuer (General Description and Financial Matters)
- Risk Factors
- Continuing Disclosure



Official Statement (continued)

❖ OFFICIAL STATEMENT

➤ Contents (continued)

↘ Concluding Information

- Tax Matters
- Ratings
- Litigation

↘ Appendices

- Economic and Statistical Data re Issuer
- Audited Financials
- Form of Bond Counsel Opinion
- Summary of Legal Documents
- Credit Enhancement



Continuing Disclosure



Overview

- ◆ Rule 15c2-12
- ◆ Duty to update



Continuing Disclosure (cont'd)



Annual report

- ◆ What to include
 - ◆ Audit
 - ◆ Other Specified Information
- ◆ When to file
- ◆ How / where to file
 - ◆ MSRB EMMA System
 - ◆ emma.msrb.org



Continuing Disclosure (cont'd)



Material events

- ◆ Be aware of 11 events
 - ◆ Rating changes (underlying OR credit-enhanced rating)
- ◆ Consult with professionals
- ◆ Requires filing upon happening of event



Continuing Disclosure (cont'd)



Compliance regime

- ◆ Understand obligations
- ◆ Assign responsible officer
- ◆ Hire consultants



Continuing Disclosure (cont'd)



Failure to comply

- ◆ Disclosure requirement for 5 years
- ◆ Statements to the Market – Potential Fraud Liability



Federal Tax Law Compliance



General Principles

- ◆ No Private Use (5% exception)
 - ◆ Sale
 - ◆ Subleases
 - ◆ Management Contracts
- ◆ No Private Loan
 - ◆ E.g., sale or lease of surplus property



Federal Tax Law Compliance (cont'd)

◆ Arbitrage/Rebate

◆ Arbitrage

◆ The investing of bond proceeds at an interest rate above the bond yield

◆ Bond Yield 5%

◆ Investment Rate 6%

◆ Arbitrage 1%

◆ Rebate

◆ Return to federal government all arbitrage not fitting within an exception

◆ Spending exceptions 6, 18 and 24 month



Federal Tax Law Compliance (cont'd)



Arbitrage Rules

- ◆ Construction Fund
 - ◆ Yield Restriction after 3 years
- ◆ Debt Service Fund
 - ◆ Annual Cleanout
 - ◆ Invested Sinking Fund



Accounting and Reporting Issues

-  Understand arbitrage and rebate rules
-  Tax laws to know and adhere to
-  Track each project with unique accounting codes
 - ◆ Sub-fund: each debt issuance
 - ◆ Cost center: each construction project
-  Use a calendar based tracking system



Avoiding Arbitrage Situations



Know your arbitrage window

◆ 6, 18 or 24 months?



Issue only the amount you need for the next window

◆ but allow for delays, increases, change orders, etc.



Work closely with your facilities manager, architect, contractors



Establish a project tracking system

◆ Will be useful later if you need to litigate for errors & omissions, critical delays, etc.



Example Planned Schedule

2001												2002												2003											
J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D					

Demo/Grading = \$500,000

6/25 6/30

Concrete Footings/S.O.G./Underground = \$1,500,000

7/7 10/28

Structural Steel = \$1,000,000

10/27 11/26

Plumbing = \$500,000

11/11 \$500,000

Framing = \$500,000

1/1 4/21

1/13 2/10

Insulation/Drywall = \$500,000

F.H.: 2/25 5/12

4/22 7/8 Electrical / HVAC = \$1,500,000

Roofing = \$400,000

4/22 6/2

Finishes = \$600,000

4/22 10/31

- Planned Dates
- Actual Dates
- Sporadic Work
- Critical path

Track plan vs. actuals

Sequence: Concrete then Framing then Finishes

Anticipate magnitude of progress payments

Total Needed thru 18 months = \$7 million (but don't box yourself in)



Federal Tax Law Compliance (cont'd)

- ◆ Consequences of Failure to Comply
 - ◆ IRS Audit
 - ◆ Taxability of Bonds
 - ◆ Penalties